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Remarks by Philip B. Chenok, National Joint Ethics Enforcement Conference

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REMARKS
BY
PHILIP B. CHENOK

NATIONAL JOINT ETHICS ENFORCEMENT CONFERENCE

NOVEMBER 19, 1980
SHERATON-ATLANTA HOTEL
ATLANTA, GEORGIA

GOOD AFTERNOON LADIES AND GENTLEMEN.

I AM DELIGHTED TO BE WITH YOU TODAY TO SHARE A FEW IDEAS ABOUT SELF-REGULATION AND THE ROLE OF PROFESSIONAL ETHICS IN THAT PROCESS.

AS YOU ARE UNDOUBTEDLY AWARE, OUR PROFESSION HAS UNDERTAKEN A SELF-REGULATORY EFFORT THAT IS UNPARALLELED IN THIS OR ANY OTHER COUNTRY. SOME MAY BELIEVE WE HAVE GONE TOO FAR; THAT WE HAVE GIVEN UP TOO MUCH OF OUR PROFESSIONAL FREEDOM AS A RESULT OF A FEW NOTORIOUS SITUATIONS THAT AFFECTED MAINLY LARGER FIRMS AND THEIR PUBLICLY-HELD CLIENTS. HOWEVER, AS YOU ARE ALL AWARE, PROFESSIONAL OBSOLESCENCE AND SUBSTANDARD PERFORMANCE ARE PROBLEMS THAT AFFECT US ALL -- WHETHER WE COME FROM LARGE FIRMS OR SMALL FIRMS.

WE HAVE BEEN FACED IN RECENT YEARS WITH SUBSTANTIAL CHANGES IN OUR ACCOUNTING AND AUDITING STANDARDS. WHILE THERE MAY BE CONSIDERABLE TRUTH IN THE ASSERTION THAT OUR BIGGEST PROBLEM IS STANDARDS OVERLOAD, WE MUST TRAIN OURSELVES TO LIVE WITH CHANGE IF WE ARE TO REMAIN A DYNAMIC PROFESSION. CONTINUING PROFESSIONAL EDUCATION, PRACTICE SURVEILLANCE, AND ACTIVE ETHICS ENFORCEMENT ALL FORM A FRAMEWORK FOR HELPING THE PROFESSION TO RESPOND TO CHANGE.

ONE OF THE SIGNIFICANT STEPS TAKEN IN RECENT YEARS WAS THE CREATION OF THE DIVISION FOR CPA FIRMS WITH ITS TWO SECTIONS -- ONE FOR SEC PRACTICE AND THE OTHER FOR PRIVATE COMPANY PRACTICE. THOSE THAT VOLUNTARILY JOINED THE DIVISION DEMONSTRATED THEIR BELIEF THAT PROFESSIONAL STANDARDS APPLY NOT ONLY TO INDIVIDUAL CPAs BUT TO THE UNIT WITHIN WHICH THEY PRACTICE -- THE FIRM.

FIRMS ELECTING TO JOIN EITHER OF THE DIVISION'S TWO SECTIONS VOLUNTARILY SUBMIT TO A FORM OF SELF-REGULATION. RULES OF BOTH SECTIONS REQUIRE 120 HOURS OF CONTINUING PROFESSIONAL EDUCATION OVER A THREE-YEAR PERIOD, PEER REVIEW OF MEMBER FIRM ACCOUNTING AND AUDITING PRACTICE EVERY THREE YEARS, AND IN THE CASE OF THE SEC PRACTICE SECTION, ROTATION EVERY FIVE YEARS OF AUDIT PARTNERS IN CHARGE OF SEC CLIENTS. MOST RECENTLY, THE SEC PRACTICE SECTION ESTABLISHED A SPECIAL INVESTIGATIONS COMMITTEE TO MONITOR CASES AGAINST MEMBER FIRMS AND TO BE IN A POSITION TO INQUIRE INTO CASES INVOLVING MAJOR AUDIT FAILURES. MEMBER FIRMS ARE REQUIRED TO REPORT ALL LITIGATION ALLEGING SUBSTANDARD WORK FILED AGAINST THEM ON OR AFTER NOVEMBER 1, 1979. WE ARE DELIGHTED THAT THE SPECIAL INVESTIGATIONS COMMITTEE AND THE AICPA'S PROFESSIONAL ETHICS DIVISION HAVE WORKED OUT AN AGREEMENT FOR COOPERATION WHERE THE CIRCUMSTANCES WARRANT.

THE ENTIRE PROGRAM IS STILL IN THE FORMATIVE STAGE. THE PEER REVIEW PROCESS IS EVOLVING; QUALITY CONTROL SYSTEMS AND PROCEDURES ARE BEING STRENGTHENED; THE SIC HAS JUST GOTTEN OFF THE GROUND; AND THE SANCTIONING POWER OF THE DIVISION HAS YET TO BE TESTED. YET THOSE WHO ARE INVOLVED ARE DEDICATED TO MAKING IT WORK, AND I AM CONFIDENT THAT IT WILL.

WHILE THIS EFFORT IS IMPORTANT, IT ISN'T THE ONLY SIGNIFICANT INITIATIVE TAKEN BY OUR PROFESSION IN RECENT YEARS TO IMPROVE PERFORMANCE.

DURING THE 1978 ANNUAL MEETING OF THE NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY, FORMER AICPA PRESIDENT, WALLY OLSON, RECOMMENDED THAT A STUDY BE MADE OF THE WAY THE PROFESSION IS REGULATED. OUT OF THAT RECOMMENDATION CAME THE FORMATION OF THE SPECIAL COMMITTEE ON REGULATION OF THE PROFESSION CHAIRED BY MARSHALL ARMSTRONG AND INCLUDING REPRESENTATIVES OF NASBA, THE AICPA, AND STATE SOCIETIES.

THE ARMSTRONG COMMITTEE CONCLUDED THAT THE ACCOUNTING PROFESSION HAS AN OBLIGATION TO MAINTAIN EFFECTIVE SURVEILLANCE OF PRACTICE. AND IT RAISED SERIOUS QUESTIONS OF THE EFFECTIVENESS OF OUR CURRENT SURVEILLANCE PROGRAM, WHICH UNTIL RECENTLY WAS BASED SOLELY ON COMPLAINTS. THIS IS NOW CHANGING. IN THE

AREA OF PRACTICE DEALING WITH AUDITS OF FEDERALLY ASSISTED PROGRAMS, FOR EXAMPLE, YOU HAVE ALREADY HEARD THAT THE TRADITIONAL COMPLAINT BASED SURVEILLANCE HAS BEEN SUPPLEMENTED BY POSITIVE ENFORCEMENT. TO RECAP THE SITUATION, THE INSTITUTE'S PROFESSIONAL ETHICS DIVISION BEGAN A TRI-PART ENFORCEMENT PROGRAM IN COOPERATION WITH FEDERAL GOVERNMENT AGENCIES EVEN BEFORE ISSUANCE OF THE ARMSTRONG COMMITTEE REPORT. THOSE AGENCIES ARE CONTINUING TO SUBMIT COMPLAINTS AS THEY DID IN THE PAST. IN ADDITION, AGENCIES HAVE SELECTED AUDIT REPORTS FILED WITH THEM AND SUBMITTED SUCH REPORTS TO THE ETHICS DIVISION FOR REVIEW. WHEN APPARENT SUBSTANDARD WORK IS UNCOVERED, AN INVESTIGATION IS COMMENCED IN THE SAME MANNER AS IF A COMPLAINT HAD BEEN FILED. THE THIRD PART OF THE PROGRAM CALLS FOR MEETINGS WITH THE AGENCIES TO DISCUSS FINDINGS, ROOT CAUSES OF ALLEGED SUBSTANDARD WORK, AND SOLUTIONS TO PROBLEMS. (SUCH A MEETING WAS HELD SEVERAL WEEKS AGO IN CHERRY HILL, NEW JERSEY.) TO DATE, ABOUT 230 SELECTED AUDIT REPORTS HAVE BEEN OR WILL BE RECEIVED BY THE ETHICS DIVISION AND 53 CASE INVESTIGATIONS ARE IN PROCESS.

ADOPTION OF THIS POSITIVE ENFORCEMENT PROGRAM IS ANOTHER MAJOR STEP IN MAINTAINING THE PROFESSION'S CREDIBILITY. SUCH A PROGRAM ALLOWS FOR COMMUNICATION

BETWEEN GOVERNMENT AGENCIES AND THE PROFESSION SO THAT WE PARTICIPATE IN THE FIRST INSTANCE IN THE SOLUTION TO OUR MUTUAL PROBLEMS.

THE JOINT ETHICS ENFORCEMENT PROGRAM (JEEP), AS PRESENTLY CONSTRUCTED, MELTS THE EFFORTS OF THE AICPA AND 45 STATE SOCIETIES. ANOTHER RECOMMENDATION OF THE ARMSTRONG COMMITTEE IS TO STRENGTHEN THE JEEP PROGRAM ITSELF.

THE COMMITTEE RECOGNIZED THE INACTIVITY BY MOST STATE BOARDS WITH RESPECT TO INVESTIGATION OF COMPLAINTS AND DISCIPLINARY ACTIONS. THE REPORT, THEREFORE, RECOMMENDS THAT THE RESPONSIBILITY FOR INVESTIGATIONS SHOULD BE PLACED PRIMARILY ON THE PROFESSION THROUGH THE JEEP PROGRAM. STATE BOARDS WOULD NOT THEMSELVES INVESTIGATE COMPLAINTS BUT WOULD DEFER TO THE PROFESSION UNDER NASBA SURVEILLANCE.

A FINDING UNDER JEEP OF NO VIOLATION, THE ISSUANCE OF LETTERS OF CONSTRUCTIVE COMMENT, OR ADMINISTRATIVE REPRIMANDS, WITH OR WITHOUT A CPE REQUIREMENT, WOULD RESULT IN THE CLOSING OF THE CASE WITHOUT FURTHER ACTION. IF JEEP WERE TO CONCLUDE THAT A TRIAL BOARD HEARING WAS WARRANTED, THE STATE BOARD WOULD BE INFORMED AND IT COULD THEN CHOOSE TO ENTER THE PROCESS BY HOLDING ITS OWN HEARING OR ALLOWING THE PROFESSION'S TRIAL BOARD HEARING TO PROCEED. THE STATE BOARD WOULD ALSO

HAVE THE OPTION TO ENTER THE INVESTIGATORY PROCESS AT ANY TIME, IN WHICH CASE JEEP WOULD DEFER ITS ACTION. THE IMPORTANT THING IS THAT ALLEGATIONS OF SUBSTANDARD PERFORMANCE WILL NOT BE IGNORED; THEY WILL BE DEALT WITH BY THE PROFESSION UNLESS THE STATE LICENSING BODY CHOOSES TO STEP IN.

THE ARMSTRONG COMMITTEE REPORT HAS BEEN EXPOSED TO COUNCIL AND DISCUSSED WITH INTERESTED PARTIES. A NUMBER OF STATE SOCIETIES AND STATE BOARDS ARE CONSIDERING OR ACTING ON THIS RECOMMENDATION FOR A COOPERATIVE EFFORT BETWEEN STATE BOARDS AND JEEP. WE BELIEVE THIS RECOMMENDATION TO BE HIGHLY COMPLEX, INVOLVING A NUMBER OF LEGAL AND POLICY ISSUES FOR STATE BOARDS, STATE SOCIETIES AND THE INSTITUTE. FOR EXAMPLE, CAN A STATE BOARD LEGALLY DEFER TO THE PROFESSION ACTING AS ITS AGENT? IF A BOARD CHOOSES TO HAVE THE PROFESSION CONDUCT THE INVESTIGATION, CAN THE PROFESSION BE GRANTED THE BOARD'S SUBPOENA POWER? CAN A BOARD USE EVIDENCE IN A DISCIPLINARY PROCEEDING IT HAS NOT ITSELF GATHERED? WE INTEND TO RECOMMEND FURTHER STUDY OF THESE AND OTHER QUESTIONS JOINTLY WITH NASBA. UNTIL THESE MATTERS ARE SORTED OUT, WE BELIEVE INDIVIDUAL STATE SOCIETIES AND STATE BOARDS SHOULD DELAY IMPLEMENTING SUCH A PROGRAM SO THAT IT CAN BE IMPLEMENTED ON A COORDINATED, PROFESSION-WIDE BASIS.

FINALLY, ANOTHER ARMSTRONG COMMITTEE RECOMMENDATION REGARDING PRACTICE SURVEILLANCE WOULD HAVE THE INSTITUTE, STATE SOCIETIES, AND STATE BOARDS REQUIRE THAT LICENSEES AND CPAs IN PRACTICE BE SUBJECT, ON A RANDOM SELECTION BASIS, TO A REVIEW OF THE QUALITY OF THEIR WORK WHEN ASSOCIATED WITH FINANCIAL STATEMENTS. IMPLEMENTATION OF THIS RECOMMENDATION, EVEN IF ONLY ON AN EDUCATIONAL BASIS AND EVEN IF LIMITED TO A DESK REVIEW OF REPORTS, WOULD BE HIGHLY CONTROVERSIAL -- AND VERY EXPENSIVE. NEVERTHELESS, IT DESERVES CONSIDERATION PARTICULARLY IN THIS TIME OF REEVALUATION OF THE PROFESSION'S REGULATORY ACTIVITIES. SOME HAVE SUGGESTED, FOR EXAMPLE, THAT SUCH SURVEILLANCE WOULD BE A MUCH MORE EFFECTIVE MEANS OF ASSURING PROFESSIONAL COMPETENCE THAN MANDATORY CPE.

ANOTHER MAJOR EVENT POTENTIALLY AFFECTING THE ETHICS AREA OCCURRED AT THE RECENT AICPA ANNUAL MEETING. THE REPORT OF THE SPECIAL COMMITTEE ON SMALL AND MEDIUM-SIZED FIRMS (KNOWN AS THE DERIEUX COMMITTEE) WAS DISCUSSED AT SOME LENGTH. AMONG THE MATTERS INCLUDED IN THAT REPORT WAS THE RECOMMENDATION THAT THE INSTITUTE'S ETHICS DIVISION EXPAND ITS INTERPRETATIONS OF FALSE, MISLEADING, OR DECEPTIVE ACTS TO INCLUDE A LIST OF MISLEADING SOLICITATION PRACTICES. (YOU MAY RECALL THAT THE

QUESTION OF PROFESSIONALISM ALSO WAS RECENTLY ADDRESSED BY FORMER AICPA CHAIRMAN BILL GREGORY IN A SPECIAL SUPPLEMENT- TO THE CPA LETTER.) MISLEADING SOLICITATION PRACTICES, THE COMMITTEE SAID, MIGHT INCLUDE SUBMISSION OF A FEE ESTIMATE WITH THE KNOWLEDGE THAT THE FEE IS LIKELY TO BE SUBSTANTIALLY INCREASED BECAUSE OF THE ADDITIONAL WORK WHICH WILL BE NECESSARY TO COMPLETE THE ENGAGEMENT; OR THE SUBMISSION OF A FEE ESTIMATE FOR ONE PERIOD WITH AN IMPLICATION THAT THE FEE WOULD BE COMPARABLE IN A SUBSEQUENT PERIOD IN CASES WHERE THE CPA HAS KNOWLEDGE THAT THE FEE WILL BE INADEQUATE FOR SUBSEQUENT PERIODS.

THE DERIEUX COMMITTEE REPORT ALSO CONSIDERED THE ISSUE OF BELOW-COST FEES. IT WAS THE COMMITTEE'S RECOMMENDATION THAT THE ETHICS DIVISION STUDY THE POTENTIAL EFFECTS OF BELOW-COST FEES ON INDEPENDENCE AND CONSIDER ISSUING AN INTERPRETATION OF THE INDEPENDENCE RULE ON THIS SUBJECT. THIS COULD TAKE THE VIEW THAT A BELOW-COST FEE IS SIMILAR TO AN INVESTMENT IN A CLIENT OR AN UNCOLLECTED RECEIVABLE.

OF EVEN GREATER SIGNIFICANCE WAS A RESOLUTION ADOPTED FOR THE APPOINTMENT OF A SPECIAL COMMITTEE, "TO STUDY THE RAMIFICATIONS OF THE PRESENT STATUS OF RULES PERTAINING TO DIRECT, UNINVITED SOLICITATION AND THE LEGALITY OF SUCH RULES." THE SPECIAL COMMITTEE WAS REQUESTED TO REPORT

BACK TO THE MEMBERS OF THE AICPA AT LEAST ONE MONTH PRIOR TO THE 1981 ANNUAL MEETING. THE COMMITTEE ALREADY HAS BEEN FORMED. THE CHARGE OF THE COMMITTEE HAS BEEN MISCHARACTERIZED BY SOME AS A STUDY TO REINSTATE THE RULE VS. DIRECT, UNINVITED SOLICITATION. THAT SIMPLY IS NOT SO. THE COMMITTEE'S TASK IS TO STUDY THE ISSUE AND THE RESULTS OF THAT STUDY CANNOT BE PREDETERMINED. OBVIOUSLY, THE REPEAL OF THE SOLICITATION RULE HAS CAUSED SOME SERIOUS CONCERNS FOR OUR MEMBERS. A CAREFUL REVIEW OF THIS SITUATION IS IN ORDER AND WILL BE ACCOMPLISHED BY THE SPECIAL COMMITTEE UNDER THE ABLE CHAIRMANSHIP OF BILL GREGORY.

I'VE DISCUSSED SEVERAL OF THE ACTIONS TAKEN TO EXPAND AND IMPROVE OUR SYSTEM OF PROFESSIONAL SELF-REGULATION AND A NUMBER OF PROPOSALS WHICH WE MUST CONSIDER IN DETERMINING THE FUTURE COURSE OF OUR REGULATORY PROGRAM. AS THIS PROGRAM EVOLVES, AND WHATEVER DIRECTION IT MAY TAKE, ITS SUCCESS REQUIRES THE COMMITMENT AND INVOLVEMENT OF SOCIETY AND INSTITUTE MEMBERS.

IN PARTICULAR, YOU WHO REPRESENT THE ETHICS FUNCTION OF YOUR STATE SOCIETIES AND THE MEMBERSHIP OF JEEP HAVE THE RESPONSIBILITY, TOGETHER WITH YOUR COLLEAGUES, OF HELPING TO MAKE OUR SELF-REGULATORY SYSTEM WORK. YOUR RESPONSIBILITY IS HEAVY AND YOUR EFFORTS, AT TIMES, I KNOW UNPOPULAR. I

COMMEND EACH OF YOU FOR ASSUMING THIS ROLE IN THE SERVICE OF YOUR PROFESSION.

HOWEVER DIFFICULT THE TASK YOU PERFORM, I HOPE YOU ALSO REALIZE HOW IMPORTANT AND NECESSARY IT IS TO THE PROFESSION. WE HAVE A LEGITIMATE ROLE IN THE ENFORCEMENT PROCESS AND AN OBLIGATION TO BE A PART OF IT.

THE INSTITUTE AND STATE SOCIETIES THROUGH BYLAWS, COUNCIL RESOLUTIONS, AND JEEP CONTRACTS HAVE DEVELOPED A STRUCTURE FOR INQUIRING INTO SITUATIONS WHERE THERE MAY HAVE BEEN DEPARTURES FROM STANDARDS AND TAKING ACTION BASED ON THESE INQUIRIES. THIS SYSTEM IS BEING TESTED, AND WE MUST COMMIT OURSELVES TO MAKING IT WORK, AND THEREBY, MAINTAINING AND STRENGTHENING OUR CREDIBILITY.

WE NEED PARTICULARLY TO PUBLICIZE THE FACT THAT AN EFFECTIVE ETHICS ENFORCEMENT PROGRAM EXISTS IN OUR PROFESSION. INFORMING THE PUBLIC THAT THE PROFESSION WILL ACT IN CIRCUMSTANCES OF INCOMPETENT PERFORMANCE IS A NECESSARY COMPONENT TO OUR PROGRAM. BUT PUBLICIZING THE EFFORT CARRIES WITH IT A COMMITMENT TO PERFORM. AND THAT WE MUST DO!

CONTINUED COMMITMENT ON YOUR PART WILL CONTRIBUTE TO MORE EFFICIENT HANDLING OF CASE INVESTIGATIONS, BETTER

UTILIZATION OF THE TALENT AVAILABLE TO US, AND A BROADER BASED SUPPORT FOR WHAT WE'RE ATTEMPTING TO DO.

CLEAR AND PRECISE PROCEDURES FOR THE CONDUCT OF ETHICS INVESTIGATIONS ARE ESSENTIAL. THEY WILL ENABLE US TO PROCEED MORE EXPEDITIOUSLY AND WITH GREATER UNDERSTANDING, COMPETENCE, AND CERTAINTY THAT WE ARE ACTING TOGETHER IN OBSERVING DUE PROCESS REQUIREMENTS AND GATHERING ALL THE INFORMATION NECESSARY FOR AN INFORMED AND IMPARTIAL JUDGMENT.

INCREASED COOPERATION AND CONTACT IS NEEDED AMONG THE MEMBERS OF JEEP TO FOSTER THE TRUST AND UNITY NECESSARY TO SUCCESSFULLY COMBINE OUR RESOURCES AND EFFECTIVELY SHAPE THE COURSE OF THIS SENSITIVE AND IMPORTANT ENFORCEMENT WORK.

IN CLOSING, LET ME REMIND YOU THAT WHEN THE CURRENT CODE OF PROFESSIONAL ETHICS WAS SENT TO THE MEMBERSHIP FOR ADOPTION, IT WAS ACCOMPANIED BY EXPLANATORY MATERIAL WHICH CONTAINED LANGUAGE AS PERTINENT TODAY AS IT WAS THEN. I QUOTE:

"A CODE OF ETHICS, COMPREHENSIVE IN SCOPE, SUITED TO PRACTICAL APPLICATION AND ELEVATED IN AIM, SERVES NOT ONLY AS A GUIDE TO

PRACTITIONERS IN DEALING WITH QUESTIONS THAT ARE OFTEN COMPLEX; IT IS ALSO ASSURANCE FOR THE PUBLIC. AND IT EVIDENCES TO YOUNG PERSONS OF TALENT AND IDEALS THAT ACCOUNTANCY OFFERS AMPLE OPPORTUNITY TO ACHIEVE PERSONAL GROWTH, TO EARN THE RESPECT OF THE COMMUNITY, AND TO CONTRIBUTE TO THE WELL-BEING OF SOCIETY."

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